In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 334

FRANK IX & SONS VIRGINIA CORPORATION, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

This case involves the circumstances under which losses, incurred prior to a corporate reorganization that preceded the effective date of the Internal Revenue Code of 1954, may be carried forward to offset post-reorganization profits earned in 1957, 1958, and 1959. Resolution of this question presents two issues: The first is whether, as petitioner contends, the carryover is governed by Section 382(b) of the 1954 Internal Revenue Code. If so, the Commissioner would agree the carryover is proper. On the other hand, if Section 382(b) is not the governing provision, the question becomes whether petitioner's carryover is allowable

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under the continuity of business enterprise doctrine of *Lisbon Shops, Inc.* v. *Koehler,* 353 U.S. 382, which interpreted Section 122 of the 1939 Code.

The Tax Court held that the carryover was barred by *Libson Shops, Inc.* v. *Koehler, supra* (Pet. 19). The Third Circuit, affirming the decision of the Tax Court, held that *Libson Shops* applies with respect to corporations that are combined through a reorganization effected before the effective date of Section 382(b), as was petitioner, and that no loss carryover was available here (Pet. 27).

The decision below is correct on both issues. Such conflicts as exist with decisions of other courts of appeals are not of administrative importance sufficient to warrant further review by this Court.

Prior to September 30, 1953, petitioner manufactured woven synthetic fabrics in Cornelius, North Carolina. It incurred substantial net operating losses for the taxable years ending March 31, 1952, 1953, and 1954. On September 30, 1953, petitioner was reorganized pursuant to a plan whereby it acquired in exchange for shares of its own stock the assets of another corporation that manufactured the same type of fabric in a mill in Charlottesville, Virginia, and whose stock was owned by the same individuals in the same proportions as was petitioner's. The Virginia corporation was dissolved, and its holdings of petitioner's stock distributed to its stockholders. (R. 7a–11a.)[1]

[1] "R." references are to petitioner's appendix in the Third Circuit.

Petitioner continued to operate the Cornelius mill at a loss until July 22, 1954, when it was shut down. The Charlottesville plant continued to operate profitably, as it had prior to the acquisition (Pet. 18). On its federal income tax returns for the years 1957, 1958, and 1959, petitioner claimed deductions for the net operating losses sustained in the tax years ending March 31, 1953 and 1954.

1. Section 382 of the 1954 Code defines specific circumstances under which a corporation may not carry over losses incurred before a change in ownership or a reorganization against profits realized thereafter. By reason of Section 382(b)(3), however, such a carryover is available where, as here, there is a reorganization of two corporations owned "by the same persons in the same proportions." Accordingly, were this case governed by Section 382(b) the carryover would not be barred.

However, other sections of the 1954 Code make it clear that Section 382(b) could not apply to petitioner's claimed carryover. Section 394(c) provides that "Section 382(b) shall apply to reorganizations, the tax treatment of which is determined under this Code." Section 393(b)(1) provides that the 1954 Code "shall apply only in respect of plans of reorganization adopted on or after June 22, 1954. * * *" Since petitioner's reorganization took place in 1953, Section 393(b)(1) places the reorganization beyond the ambit

of the 1954 Code.[2] Consequently, Section 394(c) prohibits the application of section 382(b) in the present case, as the Third Circuit held. Accord, *Allied Central Stores, Inc.* v. *Commissioner,* 339 F. 2d 503, 504–505 (C.A. 2), certiorari denied, 381 U.S. 903.[3]

Petitioner is correct in asserting a conflict (Pet. 8) with respect to the effective date of Section 382 between the decision below and that in *Frederick Steel Co.* v. *Commissioner,* 375 F. 2d 351 (C.A. 6), petition for certiorari pending, No. 444, this Term.[4] The latter case involves Section 382(a) of the 1954 Code rather than Section 382(b). Section 382(a) sets forth rules that specify the circumstances in which a single corporation is barred from setting off against profits realized after a change in ownership (which is not the result of a tax-free reorganization) losses incurred before the change. The Sixth Circuit, apparently concluding that *Libson Shops* has no vitality if a deduction of a net operating loss is claimed in a 1954 Code year

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[2] Petitioner also fails to qualify for the election of the provisions of the 1954 Code, which Section 393(b)(3)(A)(i) makes available to reorganizations adopted after March 1, 1954.

[3] *Reo Motors, Inc.* v. *Commissioner,* 338 U.S. 442, is not, as petitioner asserts (Pet. 12), to the contrary. Petitioner seems to claim that *Reo* holds that the law governing the allowability of the operating loss deduction is the law in effect in the year when the deduction is claimed; but that is precisely the approach followed by the Third Circuit, which held that the effective-date provisions set forth in the 1954 Code make clear that the special rules of Section 382(b) are inapplicable here.

[4] The petition for certiorari in *Frederick Steel* asks this Court to review the case only if certiorari is granted in the present case.

regardless of when the loss occurred, ruled in *Frederick Steel* that Section 382(a) applied in the case of a single corporation whose ownership changed in 1952, and which sought to set off prior losses against profits earned in 1955 and later years, stating, "Section 382(a) is effective as to taxable years ending after June 22, 1954. See Section 7851(a)(1)(C) and Section 395(a) of the Code in 1954. We are here concerned with taxable years ending December 31, 1954, and subsequent years. Section 382 is, therefore, applicable to the taxable years here in question." 375 F. 2d at 354. Neither of the cited sections governs the applicability of Section 382 to pre-1954 losses; the Sixth Circuit plainly erred in holding that Section 382(a) and not *Libson Shops* applied to an attempt to carry over losses incurred before 1954 to profitable years thereafter.

The question as to the effective dates of Sections 382 (a) and (b) on which the Third and Sixth Circuits are in conflict relates only to the proper transitional rule; it arises only where a set off is sought of pre-1954 losses against post-1954 earnings of a corporation which was reorganized (Section 382(b)) or whose ownership changed hands (Section 382(a)) prior to June 22, 1954, the effective date of Section 382 of the 1954 Code. The Commissioner is aware of few pending cases,[5] in addition to the present one and *Frederick*

[5] In addition to the case of *Amherst Coal Co., et al.* v. *United States*, Nos. 2604–2606 (S.D. W. Va.), referred to in the government's petition for certiorari in the *Frederick Steel* case, further research has revealed these additional cases: *Supervised Investors Services, Inc.* v. *United States*, No. 66–C–45 (N.D.

Steel, in which this question is raised, and future cases are unlikely to arise. In these circumstances, this issue does not have sufficient administrative importance to warrant review by this Court.

2. The Third Circuit was also correct in holding that the carryover claimed by petitioner is barred by this Court's decision in *Libson Shops, Inc.* v. *Koehler, supra.* In that case a group of individuals owned the same proportionate interests in sixteen corporations which were engaged in the sale of women's apparel at retail, and in a seventeenth which provided management services for the others. The sixteen operating corporations were merged into the management corporation in a tax-free reorganization that did not alter the preexisting ownership ratios. The question was whether the 1939 Code allowed operating losses that three of the operating corporations sustained before the merger to be carried forward to offset post-merger profits of the consolidated enterprise. This Court held that the loss carryover was not allowable since the business that incurred the losses was not the same one that earned the profits. 353 U.S. at 390. Nothing was found in the legislative history of the loss carryover provisions to "permit the averaging of the premerger losses of one business with the post-merger income of some other business which had been operated and taxed separately before the merger." *Id.* at 387.

Ill.); *Commercial Industries Co.* v. *United States,* No. 565–64 (D. N.J.); *Roberts Co.* v. *Commissioner,* T.C. Docket No. 6024–64. All four cases involve approximately $1,132,000 in total tax liability.

As the Third Circuit observed here, the facts in this case are "remarkably close to the circumstances which existed in *Libson Shops* * * *" (Pet. 21). Two corporate units, each a separate legal and economic entity when one of them incurred substantial losses, were reorganized into one entity, "and the assets which produced the income against which earlier losses were sought to be applied were different from the assets which produced the losses." (Pet. 21.) The result here is, moreover, in accord with the results reached in *Allied Central Stores, Inc.*, v. *Commissioner*, 339 F. 2d 503 (C.A. 2), certiorari denied, 381 U.S. 903; *Julius Garfinckel & Co.* v. *Commissioner*, 335 F. 2d 744 (C.A. 2), certiorari denied, 379 U.S. 962; *Huyler's* v. *Commissioner*, 327 F. 2d 767 (C.A. 7); and *Foremost Dairies, Inc.* v. *Tomlinson*, 341 F. 2d 580 (C.A. 5).

Petitioner is arguably correct in asserting a conflict between the results of applying the *Libson Shops* principle here and in *United States* v. *Jackson Oldsmobile, Inc.*, 371 F. 2d 808 (C.A. 5). In *Jackson Oldsmobile*, a corporation was allowed to carry over losses incurred during 1953 in selling Buicks in Colorado against profits earned during 1956 and 1957 in selling Oldsmobiles in Georgia. There was no reorganization, however, and throughout the period General Motors Corporation held a majority of the voting stock of the single corporation involved. The Fifth Circuit agreed with the district court that "under all the facts of this case, the principle of *Libson*

Shops, Inc. v. *Koehler* did not bar this carry over * * *."[6] It is not at all clear, however, that a conflict exists in the sense that on the present record the Fifth Circuit would have reached a different conclusion than did the Third. Compare *Foremost Dairies, Inc.* v. *Tomlinson, supra,* where the Fifth Circuit affirmed *per curiam* a district court denial of a loss carryover on the authority of *Libson Shops* in the presence of a corporate reorganization of a dairy and a frozen food processor into a single entity. See, also, *Norden-Ketay Corp.* v. *Commissioner,* 319 F. 2d 902, 905 (C.A. 2).

A decision by this Court in the present case could not in any event resolve any issue of substantial continuing importance. The Commissioner would concede that this case should have been decided differently if the reorganization had taken place on or after June 22, 1954. The Internal Revenue Service has ruled that it would not urge the rule of *Libson Shops* as an independent basis for disallowance of net operating loss carryovers as to any reorganization described in Section 381(a) of the 1954 Code, and thus governed by Section 382(b). See Rev. Rul. 59–395, 1959–2 Cum. Bull. 475, 480, and Rev. Rul. 58–603, 1958–2 Cum. Bull. 147. Accordingly, the question of the applicabil-

[6] In *Jackson Oldsmobile* the district court stressed that the case involved a single corporation whose majority ownership did not shift, rather than a merger of multiple corporations as in *Libson Shops*. This Court in *Libson Shops* distinguished and reserved judgment on cases where "a *single* corporate taxpayer changed the character of its business * * *." 353 U.S. at 390, n. 9 (emphasis in original).

ity of *Libson Shops* to cases such as this one, which would be governed by Section 382(b), will not arise in the future.[7]

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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[7] The Service has also conceded that *Libson Shops* has only limited vitality in the single corporation cases governed by Section 382(a). See, Rev. Rul. 63-40, 1963-1 Cum. Bull. 46, and T.I.R. 773, October 13, 1965.

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